

**MINUTES OF A MEETING
KENTUCKY WORKERS' COMPENSATION FUNDING COMMISSION
BOARD OF DIRECTORS**

January 25, 2017

Opening of Meeting:

1. A regular meeting of the Board of Directors of the Kentucky Workers' Compensation Funding Commission was held on January 25, 2017, in the Commission's conference room, located at 42 Mill Creek Park, Frankfort, Kentucky. Madam Chair Judy Long called the meeting to order, verified public notice had been given, and asked for a roll call.

Directors Present:

2. Judy Long, Self-Insured Employers Representative
Derrick Ramsey, Secretary, Labor Cabinet
Duran Hall, Commercially Insured Employers
Edwin King, Designee for Secretary William Landrum, Finance & Administration Cabinet
Michelle Landers, Insurance Representative, KEMI
Caroline Baesler, Designee for Secretary Terry R. Gill, Jr., Cabinet for Economic Development

Others Present:

3. Reuben Jones, Executive Director, KWCFC
Renee Haddix, Director of Audit and Collections, KWCFC
Louie Hord, Director of Fiscal Operations, KWCFC
Lisa King, Audit Review Manager, KWCFC
Angela Calloway, Fiscal Services Officer, KWCFC
Gordon Stammel, Computer Network Manager, KWCFC
Michael Swansburg, General Counsel, Labor Cabinet
Mike Nemes, Deputy Secretary, Labor Cabinet
Brooken Smith, Chief of Staff, Labor Cabinet
Kim Bechtel, Financial Portfolio Administrator, Office of Financial Management (OFM)
William Emrick, Acting Commissioner, Department of Workers' Claims
Judith Erickson, Division Director, Workers' Compensation Funds
Ed O'Daniel, Attorney
Travis Anderkin, Van Meter Insurance
Mike Hostetter, Van Meter Insurance
4. Reuben Jones, Executive Director, announced in accordance with Kentucky Statute 61.835 the meeting will be recorded.

Introductions:

5. Madam Chair Judy Long announced Governor Bevin appointed Terry R. Gill, Jr. as Secretary of the Cabinet for Economic Development, effective January 1, 2017.
6. Madam Chair Long also introduced Bill Emrick as Acting Commissioner, Department of Workers' Claims.

Approval of Minutes:

7. Secretary Derrick Ramsey made a motion to approve the November 17, 2016 Minutes. Ms. Caroline Baesler seconded the motion. Motion carried.

Financial Report: Louie Hord (report on file for referral)

8. Louie Hord reviewed the year to date budget versus actual expenses for KWCFC, the year to date internal financial statements, and fiscal year to date interagency transfers made by KWCFC for the period ending December 31, 2016.
9. Ms. Baesler made the motion to accept the Financial Reports as presented. Edwin King seconded the motion. Motion carried.

Investments: Kim Bechtel (report on file for referral)

10. Kim Bechtel presented the Investment Positions/Strategies detailing the different type of investments for the mid portfolio. This mid portfolio shows the original cost and the total value as approximately \$543M which reflects the unrealized loss that is occurring right now because of the selloff in treasuries. The second report details the actuarial projections versus the actual results currently for the month of December 2016. Ms. Bechtel provided The Special Fund Projected Cash Balance, the Securities Lending Results, and pointed out the utilization rate has gone down having only affected the income slightly. Ms. Bechtel's report on the performance of the mutual funds for the Coal Workers' Pneumoconiosis (CWP) Fund shows the current market value is just over \$11M.
11. Ms. Bechtel updated the Board that OFM is ready to issue the Request for Proposal (RFP) for the custody contract which expires June 30, 2017. Once the RFP is posted she will inform Mr. Hord. OFM hopes to have the contract awarded in April.
12. Duran Hall made the motion to accept the investment report. Mr. King seconded the motion. Motion carried.

Investment Committee Report: Reuben Jones (report on file for referral)

13. Mr. Jones updated the Board concerning the Investment Committee meeting held on January 9, 2017. The purpose of the meeting was to bring back recommendations on adjusting the investment strategy to achieve a greater return on investments.
14. The Investment Committee members looked at the investment history, how money is currently invested, and reviewed rates of return over the years. Rates were as high as 16% prior to the investment strategy change and are currently down to approximately 1.28%.
15. Mr. Jones stated on behalf of the Committee, it is their opinion, the Board cannot invest its way out of the current CWP Fund condition. The Committee further discussed small companies drive the industry and the demand for coal continues. The Committee also discussed potential changes in the statute relating to investments that will be achieved by working with OFM. Mr. Jones stated the change in the investment strategy in 2011 minimized the investment risk at the expense of greater returns.
16. Mr. Hord was invited to give a history of how the funds had been invested in the past and the rate of return on investment achieved during prior years. Mr. Hord reported years ago when the Board decided to invest in equities, an investment consultant was hired to make recommendations on the structure of investments. As a result, the Board decided on an investment portfolio mix of 50% Fixed and 50% Equities. To accomplish this strategy, the Commission over time hired twelve fund managers. Mr. Hord pointed out the Investment Policy Statement detailed the responsibilities of the investment consultants and fund managers.
17. Mr. King and Secretary Ramsey questioned the duplication of duties in an investment consultant and fund manager.
18. Mr. Hord stated the investment consultant lays out what type of fund managers are needed and oversees the RFP process. The investment consultant operates independently from the fund managers. The fund managers were narrowed down to 3 and met with the Board who selected the one they wanted for the particular fund they wanted to have managed. Later, due to the number of fund managers needed, the Board decided they didn't want to be part of the process so the Commission narrowed it down to 1 fund manager and presented it to the Board for decision. After hiring the managers, the consultant oversaw their performance. Every manager had performance benchmarks. If they had a couple of quarters where they did not perform to the benchmark, the consultant met with managers and addressed their performance issue. The Investment Policy Statement further detailed the responsibilities of the investment managers.
19. Mr. Jones reported the Committee recommends the need to resolve the confusion in the statute allowing for contracting for investment advice. The two

steps needed to get there are: (1) Create a current and updated Memo of Understanding allowing the Board to operate in the interim to achieve the goals at hand and (2) Approach the Legislature to clarify the statute.

20. Other recommendations are to compare investment strategies of like agencies, update the investment strategy to align with current market best practices and hire investment professionals to manage investments.
21. Mr. King commented OFM needs a better understanding of the timeline because some maturities are coming due in December.
22. Mr. Hall voiced his concern about spending lots of time developing a new investment strategy while the current administration may not be supportive of it. He said Secretary Ramsey and Secretary Landrum have taken the idea of changing the investment strategy to the current administration and they are supportive.
23. Secretary Ramsey said he informed Secretary Landrum how the investment strategy changed in 2010 due to a strong personality pushing for the 2010 investment change.
24. Mr. Hall noted most of the current Board members were not part of the Board when the investment strategy was changed to U.S. Treasuries in 2010. He said Board members rotated in and out every few years. He had asked Board members who had been Board members for a long time to explain what they knew about the change in investment strategy over the years.
25. Madam Chair Long said she had been on the Board since 2002 and years ago there was a Board member who was concerned about the investment strategy even though investments were doing very well. There was question about whether the statute supported what we were doing and we had a Board member who was very concerned about the issue. He got a lot of people involved and there was an opinion issued saying the Commission could not have an investment advisor even though the investments were doing very well. So OFM worked very closely with the Commission and Madam Chair Long said she appreciated their continued effort. Madam Chair Long stated the Commission cannot invest its way out of the current situation. The Board will certainly do what is possible to reduce or enhance the amount of money paid out for coal claims and help out the coal companies by having the return on investments to support payment of claims. Madam Chair Long said there are a lot of ideas and ways on how to look at how we handle the coal fund in the future and she will go to the committee with them.
26. Secretary Ramsey said he wanted to stress we are not going to try to invest our way out of this situation. He said it had taken a number of years to get where we are now and it will take years to get out of it. Secretary Ramsey said it will be interesting to see how the new administration in D.C. plays out over the next 90

to 120 days. The doom and gloom he thought might be over the next 3 to 5 years, could now be different. This possibility with some prudent investing is the way he would like it.

27. Madam Chair Long asked if there were any other comments. Mr. Hord stated with the position we are in right now, if interest rates go up, then the unrealized losses will continue to increase. He said currently the losses on the financial statements are unrealized losses and if they are not sold and kept to maturity then there will not be a loss. However, Mr. Hord said before interest rates go higher we need to look at U.S. Treasuries that do not have a loss or have a small loss and liquidate them to invest in equities, if the Board decides to do so. He said there was some excess cash OFM had invested in long duration U.S. Treasuries that are not matched up to liability payment program. These U.S. Treasuries could be sold before there are any big losses and then be used to invest in equities in the future, if the Board decides to do so. Ms. Bechtel said she would check into it and see what she could find.
28. Madam Chair Long asked Michelle Landers if she had a question and Ms. Landers said she was not on the Board when the decision was made, but was aware of all the questions that came up regarding the statutory authority. She said her question was about legislation because she had not seen the different opinions. Her concern going forward was some ambiguity about the possibility the statutory authority might be challenged in the future. Ms. Landers stressed the importance of getting clarification one way or another about authority before any decision is made. Ms. Landers would like to ensure a clearer path to address the authority issue will be resolved sooner rather than later.
29. Secretary Ramsey responded to Ms. Landers that is why the Board is working with OFM. Ms. Landers said she did not understand the Memorandum of Understanding (MOU) and how it might be a bridge with OFM given the statutory language.
30. Mr. King said OFM sees this as allowable under the current statute. It specifically points the Commission to OFM for advice. If they do not have the expertise, then OFM can contract out the service. The MOU would be crafted in a way which would allow OFM to go out and contract for services and KWCFC would pay for the service.
31. Mr. King went on to say he disagreed with the auditor's opinion of the statute that said if OFM does not have the expertise then the Commission could go out and contract directly with an investment advisor. He doesn't think the statute supports that, but if OFM contracts this out, it is a contract under OFM and the MOU would say how OFM is going to cooperate with the Commission. He thinks this is a way to move in this direction quickly while abiding by the statute, if the Board so chooses. If we want to change the statute it is a short session and it is jam packed so he didn't know if it would be a priority in this session. Mike Nemes, Deputy Secretary of the Labor Cabinet, said the statute could be changed in this

session if the Board so chooses. Madam Chair Long said there was a letter from OFM advising they did not have the expertise in equities and we should obtain outside investment counsel. Madam Chair Long said we want to make sure we are doing everything the statute directs us to do and if it is determined we need to make changes we want to make the regulatory changes to go forward.

32. Secretary Ramsey made a motion to accept the Investment Committee Report. Ms. Baesler seconded the motion. Motion carried.

Audit & Collections Update: Renee Haddix (report on file for referral)

33. Ms. Haddix presented an update on the number of audits ongoing and completed.
34. Mr. Hall made the motion to accept the Audit and Collections report as presented. Ms. Landers seconded the motion. Motion carried.

Executive Session:

35. Madam Chair Long asked for a motion to go into executive session under KRS 61.810 (1) (c), (f) and (j) to discuss litigation, personnel, and penalty waivers.
36. Mr. Hall made the motion to go into Executive Session. Secretary Ramsey seconded the motion. Motion carried.

Open Session:

37. Secretary Ramsey made the motion to return to open session. Ms. Baesler seconded the motion. Motion carried.

Penalty Waivers:

38. Ms. Baesler made a motion to waive penalty in the amount of \$927.10 on a one-time only basis for Acuity Insurance Company's 2013-2014 audit. Secretary Ramsey seconded the motion. Motion carried.
39. Ms. Baesler made the motion to waive penalty in the amount of \$233.51 on a one-time only basis for Marathon Petroleum Company's 2nd quarter 2016 filing of the Quarterly Premiums Report. Secretary Ramsey seconded the motion. Motion carried.
40. Ms. Baesler made the motion to waive penalty in the amount of \$57.84 on a one-time basis for Marathon Petroleum Company's 1st, 2nd and 3rd quarter 2016 Quarterly Premiums Report. Secretary Ramsey seconded the motion. Motion carried.

41. Ms. Baesler made the motion to deny the request in the amount of \$264.31 for the amended filing of B&W Resources 3rd quarter 2016 Quarterly Premiums Report, per KRS 342.1221 interest cannot be waived. Secretary Ramsey seconded the motion. Motion carried.

42. James River Coal: Madam Chair Long recused herself due to business she has with them. Mr. Hall, as Acting Chair, asked for a motion. Ms. Baesler made a motion to approve the Settlement Agreement between the Kentucky Workers' Compensation Funding Commission and James River Coal as recommended by staff. Secretary Ramsey seconded the motion. Motion carried.

Term Expiration Dates: Reuben Jones (document on file for referral)

43. Mr. Jones presented a listing of Board members and their terms were provided for information and future reference.

Commission Priorities for 2017: Reuben Jones (report on file for referral)

44. Mr. Jones presented the KWCFC Staff Priorities for 2017 as follows:

- Review of Policies and Procedures for the Commission
- Conduct a functional analysis of roles within the Commission
- Acquisition of software program for the audit program
- Enhancement of the training program for the audit program
- Modification of the QPR mailing process
- E-File/E-Pay marketing effort to increase participation
- Determine accounting software for fiscal operations
- Complete 2017 audit assignments
- Training opportunities for staff development
- Complete IT automation review

Contract Development: Louie Hord

45. Mr. Hord reported there are 5 contracts that will go out to Request for Proposal (RFP) in the upcoming year.

46. Directors & Officers Insurance has been awarded and is effective 12/31/2016 through 12/31/2017.

47. Mr. Hord stated regarding the Financial Audit he will send a letter to the Auditor of Public Accounts and ask if they want to perform the audit. If they do not want to do the audit, the Commission will need to hire an outside accounting firm following the RFP process.

48. Mr. Hall made a comment regarding the investment strategies and audit process from their committee meeting earlier. Mr. Hall suggested the actuary take one

step further in the process and provide some catastrophic scenarios regarding potential claims.

49. Mr. Jones added once the actuary completes their study, as part of the RFP, they provide a catastrophic failure scenario of the coal industry so we can start to plan for the future. This past year Mr. Jones reported he spoke to the Commission's actuary team and they could do that scenario for \$25K. He stated because the information was not needed right away, in the new contract he does not want it to be an out of scope requirement if the Board decides this is information they would like to have available. The plan is to build this requirement into the RFP to make the information readily available if so needed.
50. Mr. Hord added he also needed approval on the Actuary Study contract.
51. Mr. Hord also asked for guidance from the Board regarding the issue of the investment custodian. He asked if the Commission needed to complete an RFP or piggyback on OFM as it has been done in the past. He stated one of the benefits from using OFM is cost is much lower. OFM receives better rates because they have more money.
52. Secretary Ramsey recommended continuing with OFM.
53. Mr. Hord stated the outside legal counsel contract is in place but he isn't sure what the cost will be in the future.
54. Mr. Hall made a motion to give Mr. Hord the authority to negotiate for an actuarial study for the upcoming year. Secretary Ramsey seconded the motion. Motion carried.
55. Mr. King made the motion to negotiate an RFP for a financial audit. Mr. Hall seconded the motion. Motion carried.

Coal Workers' Pneumoconiosis Fund: Reuben Jones (presentation on file for referral)

56. Mr. Jones presented the Board with ideas to address concerns with the CWP funding. Factors affecting the fund are the decline in the industry, the continual increase in rates, the industry's uncertain future and the need for legislative action to eliminate confusion in the KRS statute.
57. Mr. Hall introduced two representatives from Van Meter Insurance Company, Mike Hostetter and Travis Anderkin and stated they would like to address the Board. Mr. Hostetter expressed the need to find answers to help their coal clients. Mr. Anderkin asked for clarification on why some insurance companies are reporting differently than other companies. He stated KEMI is charging the full amount across the board for coal tax but AIG is not doing so. Mr. Anderkin

added one company is not severing coal or processing it and being charged the 49.5% on \$2.2M in payroll.

58. Secretary Ramsey stated the Governor and Legislature are aware of the situation with the CWP Fund. He explained the Committee is looking at ways to try to help. Mr. Hostetter replied companies are looking for immediate relief.

59. Madam Chair Long expressed her appreciation to the guests for coming to the meeting and pointed out a large portion of the meeting was spent addressing the issues. She asked Mr. Hostetter to develop and submit questions so the Board could answer in the best way possible. Madam Chair Long stated the Board and the Administration are working very hard and it is a priority to address the coal situation.

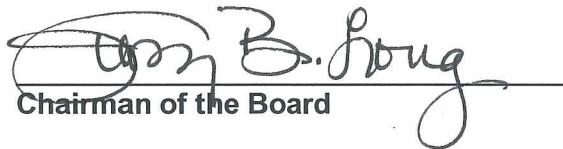
Other Comments:

60. Ms. Landers asked about the agenda item of legal counsel hiring update that was not discussed. Mr. Jones stated there is no update at this time.

61. Following discussion for clarification through Mike Swansburg, legal counsel, Ms. Baesler made the motion for the Board to approve the legislative initiative to reflect their flexibility to consult with an outside party and OFM to invest funds. Secretary Ramsey seconded the motion. Motion carried.

Adjournment:

62. Mr. Hall made the motion to adjourn. Ms. Baesler seconded the motion. Motion carried.


Chairman of the Board